October 27, 2011

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Box 1903
Toronto, ON M5H 3S8

Dear Mr. Stevenson,

Re: Notice and Request for Comments re Proposed Amendments to National Instrument 51-103: Ongoing Governance and Disclosure Requirements For Venture Issuers.

As members of the Ontario Securities Commission’s Investor Advisory Panel (IAP), we enclose in this letter our submission regarding Notice and Request for Comments re Proposed Amendments to National Instrument 51-103: Ongoing Governance and Disclosure Requirements For Venture Issuers (the “Proposed Instrument”).

The IAP is an independent body that was appointed by the Ontario Securities Commission in August, 2010. We are charged with representing the views of investors and providing input on the Commission’s policy initiatives, including proposed rules and policies, the annual Statement of Priorities, concept papers and other issues.

1. OVERVIEW

The Proposed Instrument aims to tailor regulatory requirements to the needs of venture issuers and investors. According to the Canadian Securities Administrators (CSA), these issuers generally have limited financial resources, (i.e., compliance imposes a comparatively high cost); may have a longer horizon for generating significant profits; and, may be more likely to have ongoing needs for capital over a longer period, hence would benefit from easier and less costly access to public financing.  

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1 We have been assisted by the valuable research and preparation of this letter by Ms. Chava Schwebel, J.D. student at the Faculty of Law, University of Toronto.

The CSA notes that venture investors are typically small retail investors, who, in the absence of a significant amount of analyst or broker generated market research, are more likely to rely on material information about a company than its historical financial information in making their investment decisions. The proposed rules were therefore designed to reduce costs for venture issuers and to accommodate (what the CSA presumes to be) the lower information requirements of venture investors.

We begin by explicitly stating our support for the continued development of a vibrant small issuer market, which contributes towards the development of competitive advantages for Canada. We also believe in the need to make this market efficient and cost-effective for issuers. Notwithstanding our support of this broad principle, our primary concerns with the current proposal are as follows:

i. **No Cost-Benefit Analysis.** Absent further examination, including a cost-benefit analysis which is required under the *Securities Act* (Ontario) to be published with each proposed rule, we believe that it is premature to alter the disclosure and governance rules for venture issuers.

ii. **Elimination of Key Continuous Disclosure Obligations.** We believe that, in principle, implementing a less stringent disclosure and corporate governance regime for venture issuers is not in investors' interests, especially given the breadth of the proposed changes in the Proposed Instrument. The elimination of mandatory quarterly reporting and amendments to material acquisition reporting are notable examples.

iii. **Limited Information.** According to the CSA’s own observations, venture investors are typically small retail investors, who do not have access to a significant amount of analyst or broker generated market research about these companies. This fact underlines the need for more rather than less information which is provided to them.

We recognize that encouraging investment in small and emerging companies is an important policy objective. However, we believe that the proposed measures do not fairly balance the interests of venture issuers against those of the investing public.

### 2. DETAILED SUBMISSIONS

Our concerns with the proposed regulatory changes derive from a number of principles, which have been applied in other venues, namely, that:

- A primary objective of regulation is to protect investors, especially retail investors who are typically less sophisticated and therefore more vulnerable;

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5 *Id.* 213.
4 *Id.*
5 *Securities Act* (Ontario), s. 143(2).
• This objective must be balanced against the other objectives of the statute, namely market efficiency, but it should not be unduly compromised in the process;
• The benefits of any regulatory amendments should outweigh the costs;
• Where there is limited public information about a particular market segment, policies should promote the provision of more information, rather than less; and,
• Continuous disclosure plays an important role in ensuring transparency and preventing inaccurate financial and management reporting. These regulatory requirements should not be diluted without strong empirical justification.\(^6\)

Accordingly, we note the following concerns with regard to the Proposed Instrument.

**Absence of a Cost-Benefit Analysis**

We believe that without a detailed cost-benefit analysis, it is premature to make any conclusions about the merits of the Proposed Instrument. We recognize that how to structure and define a cost-benefit analysis can be complex and depends on how the various interests in the venture market are balanced. For example, one may choose to examine the costs and outcomes of regulation. From the venture issuer standpoint, cost-benefit will be defined in terms of the cost of compliance, while from the investor perspective, it is necessary to assess information to determine the cost-benefit or risk of an investment. Finally, one needs to take into account that the objective is to design regulation that not only protects investors but also fosters fair and efficient venture capital markets. Substantial research must be done to determine the costs and benefits of these proposed changes to all venture market interests.

The changes are designed to give small companies the opportunity to raise public capital at lower costs. The idea is that reduction in financial reporting should be beneficial to smaller public companies because it will make it easier for them to attract capital. However, we are not convinced that the costs associated with existing regulatory compliance are disproportionate and prohibitive for smaller issuers. We are also concerned that the proposed measures increase the risk of fraud and manipulative abuse.

Venture companies pose greater risks to investors than larger, more established companies.\(^7\) It may be the case that lighter regulation would facilitate their growth, and

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\(^7\) There is evidence that small companies have been responsible for a large proportion of the instances of investor fraud in the United States: Dale, A. Oesterle, “The High-Cost of IPOs Depresses Venture Capital in the United States,” 1 Ohio State Entrepreneurial Business Law Journal (EBLJ) No. 2 (2006) at notes 65, 67. For example: Arthur Levitt Jr., “A Misguided Exemption,” Wall St. J., Jan. 27, 2006, at A8 (“Consider that these [small] companies are the ones most likely to have internal control problems, and least likely to have analysts, institutional investors and the media watching them.”); Steven Davidoff, “Comments on Business Law Professor Blog.” Online:
economic growth in Canada more generally, but a cost-benefit analysis is necessary to demonstrate this empirically.

**Elimination of Quarterly Reports**

Under the new rules, quarterly financial reports would become voluntary and issuers would not need to include any management discussion or executive certifications. We are not convinced that the elimination of this requirement serves the CSA’s stated objective of reducing information redundancies and requiring only information that is most relevant to investors. Quarterly reports provide investors with updated information regarding a company’s business and financial performance. This information is not likely to be duplicative of past disclosure and thereby redundant to investors. In addition, if the aim is to reduce disclosure requirements, we believe that incremental, and less extensive, changes are appropriate. Possibilities include:

i. Adopting the UK approach, which requires issuers to file an interim report, but not financial statements or a formal management report and accompanying directors' certifications.

ii. Retaining quarterly reporting requirements, however, scaling item requirements to smaller issuers (such as the US has done). This increases the range of options available to venture issuers, who can provide reduced disclosure on an item-by-item, rather than absolute, basis.

iii. Requiring issuers to publish and maintain a website (similar to AIM in the UK).

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http://lawprofessors.typepad.com/business _law/2006/08/londons_ aim.html#comments (“These [small and microcap firms] are much riskier companies reflected in the higher risk premium [...]. This, combined with minimal disclosure requirements and limited available research makes them ripe for manipulation and investor fraud. Not to mention higher failure naturally.”); William K. Sjostrom, Jr., “Going Public Through an Internet Direct Public Offering: A Sensible Alternative for Small Companies?” 53 Fla. L. Rev. 529, 539, 582 (2001) (“Potential investors [...] generally have no cost-effect [sic] way to evaluate the accuracy and completeness of the disclosure and assess the fairness of the offering.”); ACSPC Report, id at 139. (“[T]hese small firms consistently have more misstatements and restatements of financial information, nearly twice the rate of large firms [...]. Alarmingly, these small firms also make up the bulk of accounting fraud cases under review by regulators and the courts (one study puts it at 75 percent of the cases from 1998-2003).”).

8 NI, supra note 2, at 11, 36.

9 In contrast, the US requires issuers to file interim financial and management reports (under section 13 or 15(d) of the Securities Exchange Act of 1934). The UK, while it mandates only half-year reporting, requires issuers to publish an interim statement between official reporting periods that describes material events and transactions, as well as the issuer's general financial position and performance (Financial Service Authority, “Disclosure and Transparency Rules” 4.3.2. See also: Directive 2004/109, of the European Parliament and of the Council of 15 December 2004 on the “Harmonization of Transparency Requirements in Relation to Information About Issuers Whose Securities are Admitted to Trading on a Regulated Market and Amending Directive” 2001/34/EC, 2004 O.J. (L 390) 38, 46).

10 17 CFR Parts 210, 228 et al. “Smaller Reporting Company Regulatory Relief and Simplification; Final Rule” SEC (January 4, 2008).

This would impose a less rigorous reporting standard on issuers, while nonetheless requiring them to regularly update investors about the company's activities and financial performance.

**Revised Material Acquisition Disclosure**

The Proposed Instrument eliminates issuers’ requirement to file Business Acquisition Reports (“BARs”) and introduces a modified ‘significance’ test, under which the threshold for triggering disclosure of major acquisitions would be increased. We believe that such an increase in the ‘significance’ threshold for disclosure of major acquisitions is inadvisable and inconsistent with our motivating principles, outlined above.

**Limited Existing Information**

The TSX Venture is a predominantly retail exchange. Because the Proposed Instrument is designed to enhance the access of venture issuers to retail investors, and vice versa, these measures target the most vulnerable group of investors. The CSA has noted that venture issuers do not typically receive much attention from analysts or brokers; hence, public information about these companies may already be limited.

A lack of independent analyst coverage limits investors’ and prospective investors’ ability to obtain an informed outsider’s perspective on a company’s suitability for investment. While we recognize that the existing framework does little to address the lack of independent analyst coverage of smaller public companies, we believe that a reduction in issuers' disclosure obligations would exacerbate this problem.

**3. CONCLUSION**

As mentioned above, the CSA has introduced the Proposed Instrument in order to reduce the disclosure obligations of venture issuers and to make public financing more accessible to these companies. We believe that capital formation and cost-effective regulation should be encouraged. However, it may be possible to further these goals while also maintaining adequate standards of good governance and transparency in keeping with the OSC’s investor protection mandate. We also believe that prescribed board governance policies should not replace a sound regulatory regime.

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12 NI, supra note 2, at 7, 12.
13 Id, 6, 222. Under the new test, financial statement disclosure in the event of an acquisition would only be required if the value of the consideration for the transaction represents 100% or more of the venture issuer's market capitalization, rather than the current asset (issuer’s share of acquired business assets compared with issuer’s assets before acquisition), investment (issuer’s investment in acquired business compared with issuer’s assets before acquisition)), and income tests (issuer’s share of the consolidated income from continuing operations of the business before and after the date of acquisition) which apply a 40% threshold for significance calculations. Under the revised test, significance may also be calculated using the market capitalization of the acquired entity as of the acquisition date instead of the announcement date of significant transactions: id. 6.
14 Supra note 2.
15 The Commission may also want to investigate policies that encourage and promote the production of independent analyst research on venture issuers.
The CSA believes that these amendments eliminate redundancies and provide an enhanced disclosure system for venture issuers. However, because the proposed amendments are extensive, more study of the risks versus benefits of these measures is necessary.

In addition, we understand that there are concerns to encourage local investment and to maintain the competitiveness of our public markets. Nonetheless, Canada does not seem to suffer from a lack of foreign or domestic investment interest. It already offers an attractive and low-cost regulatory environment. Lighter regulation of venture issuers may not be necessary preserve the competitiveness of our public markets.

In light of the OSC’s investor protection mandate, we ask that existing regulatory protections be maintained pending further study of these issues. Although venture issuers may benefit from the changes introduced under the Proposed Instrument (and this is an open question), it is well-recognized that retail investors lack the resources, sophistication, and authority to gain access to information on their own, and therefore should not be compromised in terms of the information that they receive regarding venture issuers.

Yours very truly,

The Investor Advisory Panel

Anita Anand (Chair), Nancy Averill, Paul Bates, Stan Buell, Lincoln Caylor, Steve Garmaise and Michael Wissell

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17 With the implementation of Sarbanes-Oxley, Canada is already more attractive to venture issuers than US. For example, Canadian regulators do not to require internal control audit opinions from external auditors (as required for listings on US markets under section 404 of the Sarbannes-Oxley Act, 2002). For discussion, see Eric M. Levy, Heenan Blaikie LLP “Alternative Capital Markets for U.S. Issuers: TSX and AIM,” (2006). Online: http://apps.americanbar.org/buslaw/committees/CL650000pub/materials/goingpublic.pdf.